

CALIFORNIA STATE BOARD OF EQUALIZATION

CURRENT LEGAL DIGEST NO. 1068

May 11, 2005

Revise annotation 100.0015 **Advertising Agency Acting as Agent.** An advertising agency entered into a written agreement with its clients indicating the advertising agency was the agent of the client. The agreement also provided for the agency to transfer title to all property to the client after each job was done. The agency issued resale certificates to its vendors and then marked up its cost when billing its clients on such jobs.

Under these facts, the advertising agency may have generally acted as an agent for its client by acquiring property from suppliers with a disclosed client and agency status, but it acted in a contradictory way by issuing its own resale certificate to vendors and marking up its cost when billing its clients. Also, title to these materials passed to customers when agency physically delivered them to the customer for review and approval. Therefore, the full amount charged to the client for sales of tangible personal property is subject to sales tax, including charges for “preliminary art.” Since title passed to the preliminary art, it does not meet the definition of preliminary art contained in Regulation 1540(b)(4)(A)(a)(11). 12/31/93. (Am. 2005-2).

Revise annotation 100.0120 **Computer Created Preliminary Art.** Charges for “preliminary art” created through the use of computers are not taxable provided the criteria of Regulation 1540(b)(4)(A)(a)(11) are followed. The seller must retain proof of the client’s ordering (or of the artist producing) the preliminary art prior to the date of the contract for finished art and the charge for preliminary art must be separately stated. Hard copy of each of the roughs, visualizations, layouts or comprehensives which are presented for the client’s approval must be retained for audit purposes. 5/27/93. (Am. 2005-2).

Revise annotation 100.0125 **Concept Design of Stage Sets.** A company is responsible for the concept design and follow through to the finished project of stage presentations. This includes the scenery, stage rigging, etc. The following specific sales are made by the company.

(1) The services provided by the company include conceptual design, drafting, floor plans, lighting design, and blueprints.

The charge for such design is taxable according to Sales and Use Tax Regulation 1540(c). However, tax does not apply to separate charges for preliminary art as defined in (b)(4)(A)(a)(11).

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(2) The company designs and produces the item designed.

The charge for producing and designing the item is subject to tax.

(3) Company makes a retail sale of designs or scenery. Charges include services such as production management, site labor, site survey and miscellaneous services.

Tax applies to the entire gross receipts of the sale with no deduction for charges for the various items listed.

(4) Company constructs a “tech platform” for the client and removes the platform after production.

| Tax applies to the charge for the platform. 10/23/91. [\(Am. 2005-2\).](#)

Revise annotation 100.0170. **Purpose of Preliminary Art.** A disk containing computer generated preliminary art, after being shown to and approved by the client, is sent to the typesetter who uses the disk to drive the typesetting machine. Under these circumstances, the contents of the disk do not qualify as preliminary art as they were not created “solely for the purpose of demonstrating an idea or message for acceptance by the client”, as required by in Regulation 1540 ~~(b)(4)(A)(a)(11)~~. 8/24/90. [\(Am. 2005-2\).](#)

Revise annotation 100.0190 **Title Clause.** An agreement between an advertising agency and its customer includes a title clause that states “all advertisements, copy, and layouts which are prepared shall become client’s property and shall be preserved for delivery to client upon request” is sufficient to include preliminary art. This is true even though preliminary art is not specifically mentioned. Under Regulation 1540 ~~(b)(4)(A)(a)(11)~~, “preliminary art” includes layouts. It is reasonable to interpret the contract as passing title to all “preliminary art,” particularly when “preliminary art” is not excluded from the title provisions anywhere else in the contract. Therefore, the separately stated charges for preliminary art are subject to sales tax even though the preliminary art does not become physically incorporated into the finished art. 2/28/95. [\(Am. 2005-2\).](#)

Revise annotation 100.0197 **Transfer of Artwork on Disc.** Computer generated preliminary art may be nontaxable if, for example, an artist created five different concepts on a disc and presented the designs to a client for approval. The client chooses one design and the artist recreates the design on another disc. If the artist follows the procedures in Regulation 1540 ~~(b)(4)(A)(a)(11)~~, the artist may consider the charge for preliminary art to be nontaxable. The artist must retain the medium containing the design as well as records to prove the client

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ordered, or the artist produced, the preliminary art prior to the date of the contract on approval for the finished art.

The transfer of artwork on a disc is not considered to be a transfer of a custom program. The transfer of the output is subject to tax. Tax applies to the entire charge for the artwork, including any portion of the charge attributable to programming by the retailer for their use in producing the artwork. 3/17/92. [\(Am. 2005-2\)](#).

Revise annotation 100.0250 **Where Preliminary Art is Found Taxable.** Company contracts to write, design and print a brochure for the State of California. Charges made to the state include “preliminary art.” Tax applies to the total sale price of the printed brochures with no deduction for the charge for preliminary art. “Preliminary Art” is taxable because it is not required to be prepared before entering into the contract or before obtaining approval of the finished art. Sales and Use Tax Regulation 1540**~~(b)(4)(A)(a)(11)~~**. 10/21/91. [\(Am. 2005-2\)](#).

Revise annotation 100.0304 **Artwork.** When an ad agency develops artwork for a client that will be used in reproducing the image on the packaging of software which is to be resold, the sale of the artwork is subject to sales tax. [\(Regulation 1540**~~\(b\)\(4\)\(B\)\(a\)\(7\)~~**](#).

On the other hand, when the ad agency only prepares the artwork for its own use and contracts with the client only to sell the packaging, the total charge for the sale of the packaging to the client is exempt as a sale of a nonreturnable container. (Regulation 1589(b)(1)(A).) 5/27/93. [\(Am. 2005-2\)](#).

Revise annotation 100.0308 **Campaign Literature.** A company is in the business of handling political campaigns for candidates and issues in California election contests. A contract is signed indicating that the company is an agent in the purchase of brochures and other materials. The company provides consulting and planning services in setting up the campaign and deals with the printer in the procurement of brochures and mailing pieces. The company prepares preliminary art, some final mechanical art, and some computer design which is used in the production of brochures. When brochures are finished, the company bills the candidate for the brochures separately ~~than for from~~ other consulting services, but does not usually specify on the invoice the exact printer’s charge nor does it routinely show the markup separately.

The company claims that the true object of the contract is the performance of consultant services, that the value of simple artwork done by the in-house artist is minimal, and that elaborate productions are handled by outside suppliers of art and mechanicals who charge sales tax. The company also provides creative concept copyrighting and graphic design with in-house staff for other direct-mail-product-only accounts and understands that there are “printed sales messages” which are exempt from tax.

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Apparently the company, by signing a contract “indicating that the company is an agent”, wishes to avail itself of the procedure provided in Regulation 1540(a)(2)(A)(c)(1) to act as agent for the client. Since the company both marks up the cost of the brochures and does not separately invoice the reimbursement for purchasing the property, it does not acquire the brochures as an agent on behalf of the candidate. The company makes a taxable sale of the brochure and artwork to the client.

The true object of the contract is not the performance of consulting services. The artwork or brochures are custom made properties and have value as items of tangible personal property, the sale of which is subject to sales tax. The sales of the brochures are not exempt sales of printed sales messages. “Campaign literature and other fund-raising materials” are specifically excluded from the term “printed sales messages.” 4/15/92. (Am. 2005-2).

Delete Annotation 170.0007.060, **Earnings Withholding Order (EWO) – Out-of-State Resident** (3/19/98) because it arrives at an incorrect conclusion.

Delete Annotation 198.0010, **Bankruptcy Liquidation Sales** (10/31/89) because there is no supporting backup letter .

Revise annotation 245.0680 “**Liquid Smoke.**” Liquid smoke is considered to be sold for resale to a restaurant or other customer who applies the liquid smoke as an ingredient of barbecued meats which are to be sold. See Opinion of Attorney General 10638 dated July 2, 1936. The theory is that the smoke or certain ingredients contained in it become physically incorporated into the food providing flavor to it. 8/24/64. (Am. 2005-2).

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Revise annotation 295.0065 **Consulting Services.** Separately stated charges for consulting services by a machine shop made in conjunction with the fabrication of parts by the shop are part of gross receipts subject to tax. Charges for consulting where no products are delivered are not subject to tax. 6/30/692.

Delete Annotation 295.0215, **Deposits Required by County Animal Shelters** (8/12/97) because it was superseded by R&T Code section 6010.40, operative January 1, 2000.

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Delete Annotation 295.0308, **Hand Distributing Of Advertising Materials** (12/7/83) because it is obsolete due to Reg. 1541.5 and changes to Reg. 1541.

Delete Annotation 325.0678.800, **Sale of Drill Platform** (11/20/90) because it is inaccurate.

Revise annotation: 330.20001 **Cable Television—Remote Control Units and Converters.** Cable companies are lessors of remote control units and converters which they provide to customers for a separately stated amount. The separate statement indicates an intent to lease. 12/6/84. [\(Am. 2005-2\)](#).

Revise annotation 335.00801, **Timely Election to Pay Tax on Fair Rental Value.** On February 17, 19XX, Company A purchased an aircraft from Company B. On the same day, Company A leased the aircraft back to Company B for 96 months. The sale and lease back agreement provided that the aircraft would be delivered to A and then back to B in Delaware. The aircraft would thereafter be based in California. Upon expiration of the lease, B is required to return the aircraft to A.

Company A had never held a California seller's permit and had no consumer's use tax account at the time it purchased the aircraft from Company B. Upon learning of the sale/lease, the Board sent Company A a tax return with a due date of July 31, 19XX, five months after the date of purchase. However, Company A had already filed a first and second quarter return, and paid tax on the rental payments it received from Company B, without having a permit number. Although there is a question as to when the returns were actually filed, the checks that accompanied the returns were dated July 25, 19XX.

Aircraft are "mobile transportation equipment" (MTE) and a lease of MTE is excluded from the definition of a "sale". The purchase of MTE for leasing purposes is, therefore, a retail purchase for use, not a purchase for resale. Since every person making any sale of an aircraft is a retailer, Company A's purchase of the aircraft from Company B was a retail purchase from a retailer. Under Regulation 1661(b)(2), an election to pay tax measured by the fair rental value of MTE is valid only if made timely.

Regulation 1610(c)(2)(A) provides in part, that for persons who do not hold seller's permits, shall make a return and pay the use tax measured by the sales price of the aircraft on or before the last day of the month next succeeding the month in which a return form is mailed to the purchaser, or the last day of the twelfth month following the month of purchase during which the

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aircraft is purchased, which ever period expires earlier. Accordingly, it was concluded that Company A made a timely election to pay tax on the fair rental value because they filed returns prior to the due date of the return that was sent to them by the Board. 6/21/91. [\(Am. 2005-2\)](#).

Revise annotation 355.0020 **Bindery Fabrication**. ~~Bindery fabrication, consisting of gathering in sequence of printed sheets furnished by a customer and stapling, constitutes fabricating or processing personal property for a consumer subject to tax. Taxpayer performs bindery work that consists of gathering customer furnished printed sheets, arranging them in sequence, stapling and folding the printed sheets, enclosing them in customer furnished envelopes, and sealing, sorting and mailing the printed material.~~

~~The taxpayer's organizing of the material into sequence and stapling the pages together constitutes taxable fabrication labor and the charge for this activity is subject to tax. It is immaterial that the staples may be furnished by the customer. 11/24/53. (Am. 2005-2).~~

Delete Annotation 425.0399, **Gastrostomy Tubes and Kits** (11/22/94) because it is not valid due to changes in Regulation 1951(b)(1) and (b)(5).

Revise annotation 425.0408.500 **Heimlick Chest Drain Valve and Under Water Drainage Set**. Both of these products qualify as medicines under Regulation ~~1591(j)~~ [1591.1\(b\)\(4\)\(C\)](#) because they are appliances and related supplies necessary as the result of a surgical procedure by which an artificial opening is created in the human body for elimination of natural waste. Therefore, the sale of these products is not subject to tax. However, in order to qualify as medicines under Regulation ~~1591(j)~~ [1591.1\(b\)\(4\)\(C\)](#), they must be used in post-operative situations. 5/17/84. [\(Am. 2005-2\)](#).

Delete Annotation 425.0495, **Liquid Nutrition** (3/31/92; 3/6/97) because it is not valid due to changes to Regulation 1591(b)(1) and (b)(5).

Revise annotation 425.0495 **Magnevist**. This is described as a contrast media for enhancing M.R.I. (magnetic resonance imaging) image of the brain and spine. Magnevist is a clear, colorless to slightly yellow solution which is injected into the patient in doses up to 20 ml. The labels state that Federal law prohibits dispensing the product without a prescription.

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Diagnostic products that are intended for use by internal application to the human body in the diagnosis of disease qualify as “medicines”. Magnevist qualifies as a “medicine.” However, to qualify for the exemption, the medicine must also be sold or furnished in accordance with Regulation 1591 ~~(a)(d)~~.

The company, besides selling to doctors and hospitals, also sells the products to clinical laboratories and diagnostic facilities. Sales of prescription medicines to medical facilities which do not admit patients for stays of 24 hours or longer are not covered by the prescription medicines exemption. Clinical laboratories and diagnostic facilities generally do not admit patients for stays of 24 hours or longer. As a result, sales to doctors and hospitals are exempt from tax while sales to clinical laboratories and diagnostic centers are not exempt from tax. Whether or not sales of a product are exempt from tax as a prescription medicine depends on both the nature of the product and its use. 11/20/91. [\(Am. 2005-2\)](#).

Revise annotation 425.0498 **Meadox Cardiovascular Fabrics**. Described as various knits, felts, meshes, pledgets and fabrics which are used to repair an opening or reinforce a closure in the heart or in blood vessels. These items appear to assist and strengthen the heart and blood vessels. When permanently implanted in the human body to assist the function of, the heart and blood vessels, they qualify as prosthetic devices which are exempt from tax when sold or furnished pursuant to Regulation 1591 ~~(a)(d)~~. 4/23/92. [\(Am. 2005-2\)](#).

Revise annotation: 425.0522 **Miscellaneous Items**. Summarized below is the application of tax to the sales of the following items by a licensed pharmacist pursuant to a prescription by a doctor. In some cases a prescription is not required as noted.

Alcohol, Isopropyl	exempt
Aspirator, nasal	taxable
Bandages, dressings, & gauzes (nonmedicated)	taxable; generally exempt if for ostomy patient
Sanitary napkin/tampon type	taxable
Bandages, dressings, and gauzes (medicated)	exempt
Breast pump	taxable
Catheters, external male, intermittent	nonspecific suction suction catheters are external and generally taxable. External male and intermittent catheters when used post-surgically for purposes of urinary drainage through either a

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	natural or artificial opening are exempt.
Condoms	taxable
Contraceptive creams, foams, jellies, and suppositories	exempt
Disbetie Diabetic test supplies: glucose test , Strips, and skin puncture lancets	exempt
Diabetic test supplies: tablets, tape Etc.	taxable
Diaphragms	taxable
Fountain syringe, general use	taxable
Disposable gloves	taxable
Hearing aid batteries	generally taxable; exempt if dispensed by a hearing aid dispenser licensed by the Board of Medical Quality Assurance (tax is due on the sale to licensed hearing aid dispensers)
Hot water bottle	taxable
Hypodermic needles, general use	taxable
Hypodermic syringes, general use	taxable
Incontinence supplies: disposable briefs, diapers (adult and infant), pads, shields, underpads for beds, pant systems including reusable briefs and liners.	taxable
Incontinence supplies: skin care creams and washes	exempt
Intravenous solutions administration	taxable if indicated that set billed lump sum
Invalid cushions, not fully worn on the body	taxable
Lubricating jelly	exempt
Nebulizer, bulb type	taxable
Ostomy supplies: adhesives, adhesive Removers, colostomy, fistula and ileostomy bags, urostomy bags, skin protectives, peristomal coverings, skin care creams and washes, tubes, clamps, connectors, tracheostomy supplies	exempt, prescription not necessary for ostomy patient
Sheeting, waterproof	taxable
Suspensory (athletic supporter)	exempt, orthotic device
Swabsticks, saturated	exempt
Syringe, bulb types (general use)	taxable

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Syringe, hypodermic (insulin): disposable and reusable with and without needles, various capacities	exempt
Syringe, irrigation	taxable
Thermometers taxable	
Urinary drainage/irrigation supplies: Urinary drainage collection units—leg bags	exempt if fully worn on the body
Tubes, clamps, connectors	exempt if fully worn on the body
Vaporizer	taxable. 3/3/95.

(Am. 2004-2). [\(Am. 2005-2\)](#).

Revise annotation 425.0821.935 **Silicone Drain**. Silicone drain used to drain waste as a result of an artificial opening created in the human body, as required under Regulation ~~1591.1(b)(4)(B)~~ [1591.1\(b\)\(4\)\(B\)](#), qualifies as a medicine and is not subject to tax when used post surgically. 5/17/84. [\(Am. 2005-2\)](#).

Revise annotation 425.0822 **Silicone Flat Drain 10mm, CWT Reservoir 15cc, Silicone Flat Drain**. These items are used for post operative drainage of an incision site and are subsequently removed. Assuming that the bodily fluids drain into the reservoir, these items qualify as “appliances and related supplies necessary as the result of any surgical procedure by which an artificial opening is created in the human body for the elimination of natural waste”, the sale of which are exempt from tax when sold or furnished pursuant to Regulation 1591.1(a)(b)(2). 4/23/92. [\(Am. 2005-2\)](#).

Revise annotation 440.0640 **Salt and Lye**. [The sale or use of S](#) salt used for preserving olives before processing and [the sale or use of](#) lye used in processing olives are taxable. [The sale or use of T](#) the final salt brine is exempt if ~~#~~ [the brine](#) remains with the olives when they are sold. 11/9/55. [\(Am. 2005-2\)](#).

Delete Annotation 557.0442, **Passage of Title** (12/21/77) because it is inconsistent with Regulation 1628(b)(3)(D).

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